facilities and non-discriminatory rates were not implemented for 15 years thereafter.[19] Equal access requirements and access charges leveled the IXC playing field by creating an open network in which competing suppliers could interconnect their products and services to the public network in substantially the same manner and at the same price as that available to the dominant interexchange carrier.

3. ESP and information services

In its Computer II and III proceedings, the Commission articulated a pro-competitive, pro-entry policy promising dramatic new network capabilities that ILEC competitors could use to introduce innovative services. Since then, the Commission has spent years implementing open network requirements while the ILECs have made specious claims of technical and economic harm. Rather than pro-actively prescribe unbundled elements, the Commission left it to the ILECs to volunteer a level of unbundling in their ONA plans. The ILECs offered extremely limited capabilities and unbundling in their actual ONA plans, claiming to be constrained by technical limitations in their network facilities.

Similarly, the Advanced Intelligent Network ("AIN") architecture initially proposed by the Bell Operating Companies through Bellcore excluded or

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[19] See generally, *MTS and WATS Market Structure*, CC Dkt No. 78-72, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Order (Phase I), 94 FCC 2d 852 (1983); Phase I Order Modified on Reconsideration, 97 FCC 2d 682 (1983); Phase I Order Modified on Reconsideration, 97 FCC 2d 682 (1983); Phase I Order Modified on Further Recon., 97 FCC 2d 834 (1984); Phase I Orders aff'd in part , remanded in part sub nom., National Association of Regulatory Commissioners v. FCC, 737 F.2d 1095 (D.C. Cir. 1984); cert. denied, 469 U.S. 1227 (1985); , 469 U.S. 1227 (1985); Report and Order (Phase III), 100 FCC 2d (1985); Phase I Order modified on second further recon. 101 FCC 2d 1222 (1985); aff'd sub nom. Amer. Tel. & Tel. Co. v. FCC, 832 F2d 1285 (D.C. Cir. 1987).

severely restricted interconnection to the public network.[20] Indeed, Bellcore explicitly stated that its AIN architecture was intended to give BOCs "control of the service introduction process, control of which services they develop and offer, and control of when and where they offer the services,"[21] and even went so far as to limit access to AIN capabilities to the BOCs. User access was limited to services developed and offered by the BOCs while basic network and switching system functions were available only to the BOCs.

4. Competing access transport providers

The emerging competitive success story, though extremely limited in scope thus far, came not through interconnection but via complete bypass of ILEC transport facilities by competing access providers ("CAPs"). The CAPs made limited inroads in a small number of dense, urban areas so long as they provided "dumb" transmission pipes between high-volume customers and IXC points of presence ("POPs"). But significant competitive inroads have been constrained by ILEC bundling of network features and facilities. Bundling prevents efficient interconnection of CAP transmission facilities to local switched networks in order to combine CAP services with those additional ILEC services required to complete a call.

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[20] See Bell Communications Research, Advanced Intelligent Network, Release 1 Network and Operations Plan, Issue 1, SR-NPL-001623 (June 1990).

[21] Id. at 1-2.

Thus, history, which the FCC is doomed to repeat if it ignores it, teaches that the Commission must pro-actively prescribe an aggressive unbundling plan if unbundling is ever to become a reality.

C. The Commission should unbundle more than the four basic network elements identified in the Notice

Ad Hoc supports further unbundling of the basic four network elements mentioned in the Notice. The Commission should establish a minimum level of more detailed unbundling and permit unbundling beyond that at the ILECs' and state's discretion. The minimum federal unbundling level must be defined at a sufficiently granular level to ensure that CLECs have all the building block services they need to provide competitive local exchange service. Under this standard, a proper level of unbundling in the federal rules would obviate the need for further unbundling by the states, and the issues raised in para. 109 of the Notice would be moot. Indeed, the emergence of state requirements that unbundle network elements beyond those established in the federal rules should create a presumption that the federal rules did not go far enough and must be amended.

The Notice also requested comment on whether and to what extent ILECs must allow other carriers to access the unbundled network elements proposed in the Notice. The local loop, switching, transport, and signalling system/database elements identified in the Notice track the current Part 69 access rate elements, which are obviously being made available to IXCs (and users and ESPs) now. No valid objection could be raised against providing them to CLECs. In addition,

however, the Commission should include as unbundled network elements those elements that ILECs are providing or have provided to other ILECs, including database access.

Paras. 79 and 93(4) of the Notice ask whether, and to what extent, the Commission should establish minimum requirements governing unbundling, citing as examples provisioning and service intervals, nondiscrimination safeguards, and technical standards. Ad Hoc supports such requirements because many of the state and carrier benefits of such requirements cited in the Notice inure equally to users. In particular, users would benefit from the greater network and equipment interoperability resulting from minimum requirements, the reduced need for duplicative decision-making when a user's network is distributed across more than one state, economies of scale, and the more efficient planning and deployment of interstate networks that is possible with mandatory provisioning requirements.

1. Local Loop

The Notice tentatively concludes that the loop element should be further unbundled into subelements. Ad Hoc supports further unbundling of loop plant since functional subelements exist and opportunities for competitive provision of equivalent services vary by subelement. For example, feeder plant, which concentrates individual subscriber lines onto a single facility, provides quicker opportunities for competitive entry than distribution plant, the most capital- and

labor-intensive element in a local exchange network for which no viable competition currently exists.

2. Local Switching

The Commission should unbundle individual functions within the local switch to permit CLECs to pick and choose the switch-based functionalities they need. Competitors are likely to vary in the elements they require because they have differing abilities to substitute functionalities delivered by their own networks for those provided by central office switches. FCC should reject the Illinois "platform" approach[22] because it raises entry costs for new competitors by forcing CLECs to pay for switching functions they may never need or use. CLECs, IXCs, ESPs, and users should also be given unbundled access to all the services and functions performed by the switch, not just the capacity to switch traffic from line to line. In particular, these parties need access to the unbundled switch functionalities that CLECs, ESPs and end users can use to provide logical access to their services.

The Commission should also unbundle switching elements to the level required to keep rate elements cost-causative. In other words, switching functions should be unbundled into elements that correspond to cost centers. If the number of loop connections, for example, increases switching costs, the Commission should require the ILECs to establish a switching rate element that varies by number of line connections.

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22 NPRM at ¶ 100.

3. Transmission

The Commission already unbundled switched transmission services in its transport rulemaking.[23] The Commission should retain these unbundled elements, with the exception of the Transport Interconnection Charge (formerly known more accurately as the Residual Interconnection Charge). The Commission should jettison any charge that recovers embedded residual costs, for the reasons discussed in Section III, below.

4. Signalling and databases

The Ad Hoc Committee supports the Commission's efforts to unbundle SS7 transmission services from database dips, as the current Part 69 access rate structure does.[24] In addition, CLECs will require access to databases other than those available under Part 69 (*e.g.*, subscriber tables, CRIS, and directory assistance).

The Commission should also require ILECs to unbundle logical AIN elements. The Part 69 access unbundling model tracked the physical components of local switched network architecture. That model will not be enough for AIN services. Signalling and database systems are intelligent network components but intelligent network functions are controlled by logical

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[23] *Transport Rate Structure and Pricing,* Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006 (1992), recon., First Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 5370 (1993), further recon., Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 6233 (1993), further recon. Third Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 10 FCC Rcd 3030 (1994). Fourth Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 12979 (1995). .

[24] 47 CFR Part 69.

elements that must also be unbundled.[25] Therefore, the Commission should, *inter alia*, unbundle access to advanced call processing features per its discussion in Para. 111 of NPRM.

III. PRICING STANDARDS

The Notice requests comments on a number of pricing issues raised by the 1996 Act. As detailed in the following section, the Ad Hoc Committee supports the Commission's efforts to establish the pricing rules for interconnection, unbundled network elements, and collocation services. The Committee also urges the Commission to rely on forward-looking, well-defined total service long run incremental cost ("TSLRIC") studies and to reject any attempts to inflate interconnection charges with stranded investment of lost "contribution" amounts.

A. Interconnection prices must be established with economically efficient pricing standards.

The Ad Hoc Committee urges the Commission not to burden prices for the interconnection elements with historical RORR baggage. Given the Commission's pro-competitive history it is reasonable to assume that ILECs have been preparing for competition, and it is unreasonable for ILECs to assume that they will be made whole for revenue losses related to competitive adjustments.

ILECs have recently been advancing the "stranded investment" argument under which they claim an entitlement to some pre-ordained revenue level that is

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[25] In the Matter of Advanced Intelligent Network, Coalition of Open Network Architecture Parties, Petition for Investigation (1990).

to be maintained irrespective of the relative success of LEC competitors in capturing market share. Such arguments have generally been rejected in the past. For example, the California Public Utilities Commission ("CPUC") rejected a Pacific Bell claim for some $109-million in anticipated "competitive losses" that it argued would result from the PUC's decision to permit competition for intraLATA toll services. The Commission concluded that:

> Assuring the LECs recovery of competitive losses would undermine the incentive that NRF [the New Regulatory Framework] was intended to create. The $109 million requested by Pacific and the $23.2 million requested by GTEC constitute 2% and 1%, respectively, of each company's current billing base. Compensating for competitive loss would force the LECs' customers to shelter those percentages of toll revenue from competitive risk even after rates are rebalanced, effectively granting the LECs rate cap returns on those revenues. This would be inconsistent with the ratepayer safeguards and LEC incentives established in NRF. Moreover, Pacific's and GTEC's competitors have no captive markets to provide them with a steady revenue stream if they are inefficient. The effect of Pacific's and GTEC's request would be to increase the rates of all of their ratepayers because of the prospect that some ratepayers might choose another toll carrier. This would shift the risk of competition from the LECs to their ratepayers, not a result we expect from NRF.
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> Therefore, Pacific's and GTEC's requests for compensation for competitive losses are denied. [26]

Clearly, competition cannot reasonably be expected to develop if the incumbent will always be made whole with respect to competitive losses. These claims regarding "stranded investment" arising from LEC responses to competition should be viewed in the context of the ILECs' total tangible and

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26 California PUC Investigation (I.) 87-11-033 Implementation and Rate Design (IRD) phase, Decision (D.) 94-09-065, September 15, 1994, at 164.

intangible assets, business opportunities, and future earnings potential; at a minimum, any nominal losses in economic value attributed to stranded investment should be weighed against the appreciation in value that ILECs have experienced as reflected in share prices and market-to-book ratios. As a general matter, the ILECs equity shares are trading well in excess of book value (see Appendix A).

The Commission should recognize that the production of local exchange telecommunications service necessarily involves an extensive base of common facilities whose costs are largely fixed over a broad range of services and service quantities. The manner in which ILECs assign and allocate these (largely fixed) costs among their numerous services has a direct bearing on the pace with which effective competition can emerge in the telecommunications marketplace.[27] Ultimately, the consequence of the misallocation of costs would be to deny consumers reasonable rates for monopoly services and to deprive consumers of a wide diversity of choices of potentially competitive telecommunications services. An examination of ILECs' cost studies is essential in order to, among other things, ensure that incumbents (1) do not cross-subsidize their competitive ventures with revenues derived from monopoly customers; (2) do not overprice essential unbundled network elements; and (3) do not overprice mutual compensation charges applicable for the interchange

27 Appendix B is a paper prepared by Dr. Lee L. Selwyn, submitted to the Commerce Committee of the United States Senate in March of 1995, that explains the significance of depreciation and spare capacity to the issue of cost allocation.

of traffic between incumbents and new entrants. Also, the incumbents' proposed pricing of unbundled elements will bear directly on the attractiveness of entering the local market throughout the country.

While competitive inroads may well result in an erosion of incumbent LEC market share, active competition will likely stimulate overall demand. Drawing from the experience in the interexchange market in which AT&T's once near-100% market share took nearly twenty years to erode to its present, approximate 60%, level, the ILECs are unlikely to experience any precipitous decline in its core services market share any time soon (see Appendix C). In addition, AT&T's revenues actually increased during that period (see Appendix D), belying concerns that competitive entry in the local telephone market threatens the financial viability of the ILECs. Indeed, because a change in facilities-based local dial tone provider will typically necessitate physical installation work at the customer's premises (whereas the selection of a new IXC is accomplished through a database entry made at the LEC central office), there will be far greater customer inertia in the case of local services than was experienced for long distance.

B. The Commission's regulations implementing § 251 must include detailed and comprehensive national pricing principles

As the Commission observes in the NPRM at paragraph 119, national pricing guidelines would enable the Commission[28] and state public utility commissions to review and to arbitrate contested agreements between incumbent and new local exchange carriers in a timely fashion. By contrast, the absence of such guidelines would work exclusively to the advantage of the incumbent carriers because regulatory ambiguity about acceptable rates, terms, and conditions would necessarily prolong the Commission's review of interconnection agreements. Delays in the regulatory disposition of challenged agreements postpones economically efficient entry by competitors.

Competitive entry proceedings in state jurisdictions demonstrate the reality of this phenomenon. In many states, lengthy disputes between ILECs and their potential competitors have unreasonably delayed competitive entry to the ILECs' exclusive benefit and to the detriment of potential competitors and their customers. Ad Hoc urges the Commission to avoid replicating the protracted disputes that are now occurring in numerous jurisdictions throughout the country.

National pricing principles will compensate for the disincentives ILECs have to negotiate or resolve disputes concerning CLECs interconnection. When participants in competitive commercial markets negotiate agreements, any

28 Pursuant to § 252(e)(5), the Commission may be required to assume the state's responsibility to arbitrate or review an agreement.

failure to reach agreement typically has adverse consequences of a comparable magnitude for both parties. For example, if airline pilots strike, they forego salary while the employing airline forgoes revenue (and possibly suffers from negative public relations). By contrast, in local telecommunications markets, the costs of delaying the resolution of disputes between an ILEC and a potential competitor are extremely lopsided, which diminishes the negotiating power of the new entrant. Ultimately, any delay in resolving protracted interconnection disagreements harms consumers by postponing the arrival of competitive rates and choices. For this reason, national pricing principles are critical because they will ensure the expeditious resolution of disputed negotiations.

Furthermore, national pricing principles greatly reduce the uncertainty about the outcome of a myriad of state regulatory proceedings. Predictability, rather than ambiguity, lowers a potential entrant's capital costs because Wall Street prefers predictability. By reducing the perception of risk associated with a new supplier's entry into the local market, the new entrant's cost of money will be reduced, thus enabling it to offer lower prices to the consumer.

C. The Commission must use forward-looking cost studies to comply with the 1996 Act and sound economic principles.

Section 252(d)(1) of the 1996 Act clearly contemplates the use of a forward-looking cost methodology. In the NPRM, the Commission tentatively concludes that the statutory language precludes states from setting rates using traditional cost-of-service regulation and that instead contemplates the use of "other forms of cost-based price regulation, such as price cap regulation that is

indirectly based on costs, or the setting of prices based on a forward-looking cost methodology that does not involve the use of an embedded rate base, such as long-run incremental cost (LRIC)."[29]

Ad Hoc respectfully disagrees with the relevance of price cap regulation to the initial establishment of rates for interconnection and unbundled monopoly network elements. Because price cap plans at the state and federal level have been put in place before local exchange carriers have unbundled their networks, for the most part, state PUCs and the FCC have not yet evaluated and established just and reasonable rates for interconnection. Furthermore, the quality of any individual price cap plan will determine whether, after the initial rate levels are approved by the regulation, changes to the prices for these monopoly interconnection rate elements are just and reasonable. (For example, in a state with an inappropriately low productivity offset, the changes to the prices for interconnection could be excessive.)

D. The Commission's experience with the ILECs' expanded interconnection tariffs demonstrates the need for well-defined TSLRIC studies.

The FCC's and states' experiences with the pricing of expanded interconnection illustrate the difficulty of setting fair and efficient rates for ILECs' bottleneck network elements. Rates that have been set for expanded interconnection have been fraught with controversy, and, for example, at the federal level, the Commission has directed incumbents many times to provide

29 NPRM at ¶ 123 (footnote omitted).

better cost support for their overhead allocations, rate levels, terms, and conditions for this critical component of competition.[30]

The ILECs' unwillingness to justify adequately their expanded interconnection rates, and the huge disparity among the expanded interconnection rates proposed by the various LECs, demonstrates the need for clear pricing guidelines from the FCC for those monopoly elements that are essential to the evolution of effective competition. The fact that the FCC has repeatedly found fault with the ILECs' cost studies for their expanded interconnection tariffs points out the administrative burden that results from an absence of guidelines. The price caps rules for the larger ILECs has simply been irrelevant to the initial establishment of rates, terms, and conditions for interstate expanded interconnection tariffs. The absence of pricing guidelines for expanded interconnection has permitted a prolonged process ILEC foot-dragging and the burden has fallen on other parties and regulators to oppose exorbitant rates, excessive overhead allocations, and unreasonable terms and conditions.

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30 See, for example, the FCC's statement in one of its expanded interconnection orders: "[b]ased on our review of the LECs' direct cases and accompanying cost support data filed in response to the Phase I Designation Order, we conclude that most of the LECs have failed to meet their § 204(a) burden of demonstrating that their overhead loading levels and consequently, their virtual collocation rates, are just and reasonable." Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for special Access and Switched Transport, Report and Order, 10 FCC Rcd 6375, 6376 (1995) (footnote omitted). See also Ameritech Operating Companies, et al., CC Docket No. 94-97, Order, DA 94-1421, 10 FCC Rcd 1960 at ¶ 24 in which the FCC states, "[t]hus, based on the current record, we conclude that in their tariff support materials, most LECs have failed to justify their proposals to recover a greater share of overhead costs in charges for expanded interconnection services than they recover in charges for comparable services."

West indicated that the maintenance factors are based upon plant accounts and "in some cases" adjusted for technology. The only example provided of a maintenance factor being adjusted for technology is for SONET expenses, in which the testing component of the loading expenses was estimated to be lower for SONET.[44] The use of "account" information is an inappropriate method for determining annual maintenance costs. The inclusion of a fundamentally embedded cost concept into a forward-looking incremental cost analysis should be rejected as by the Commission as a methodology that is flawed as an economic matter and entirely inconsistent with the Telecommunications Act of 1996.

Embedded maintenance costs determined as a ratio of annual maintenance expense to gross plant reflect the conditions extant under the embedded mix of technology, and may have little or no relevance to the level of maintenance costs that will be incurred in the future. Indeed, a decision to replace embedded plant may be driven, in part, by the potential for reducing maintenance costs, but this fact would escape recognition under the embedded maintenance cost approach. Maintenance expenses should be based not upon the historical experiences of a company, but rather upon the specific technology that is assumed to be acquired under the cost study. By basing operating expense factors on plant accounts, companies would overestimate the maintenance expense factor because typically new plant is more efficient and

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44 Id.

thus has lower operating and maintenance costs (relative to gross plant investment amounts) than does existing plant.

Ad Hoc supports the FCC's proposal in paragraph 132 of the Notice to use short-run marginal cost as an interim rate-setting option during the transition to TSLRIC-based pricing in order to offset the unequal bargaining positions of the new entrant and the incumbent. Ad Hoc cautions the Commission, however, of allowing the identification of an "interim" option to permit an open-ended examination of the appropriate "permanent" approach.

The FCC seeks comment in paragraph 133 of the Notice on the geographic and class-of-service disaggregation of interconnection and unbundled rate elements. Because of the substantial amount of costs that are shared among geographic areas and among the ILECs' telecommunications products, Ad Hoc cautions the Commission against balkanization of ILECs' markets, if such balkanization is used in an anticompetitive fashion. Excessive pricing flexibility will create enormous incentives to shift the recovery of common costs from geographic markets that face competition to those that do not and from products that face competition to those that do not.

There are substantial common costs associated with ILECs' provision of telecommunications services, which, in turn, creates a significant incentive to shift these joint and common costs among markets. Only if there are significant differences in the "non-common" costs that a LEC can demonstrate should the Commission permit geographic de-averaging.

L. A generic cost model is the appropriate starting point for just and reasonable prices

The NPRM suggests that there may be several advantages to establishing rate ceilings for reasonable rates of interconnection and unbundled elements and asks for comment on this approach. The Ad Hoc Committee strongly agrees with the Commission's observation that preventing excessive rates for these fundamental inputs is critical to meeting Congress's competitive objectives. The Commission has identified several important criteria by which the mechanism used to set rate ceilings should be judged: (1) that the resulting maximum prices be at levels that would still permit efficient entry by competitors; (2) that ILECs be deterred from practices that misrepresent or manipulate costs in a manner that would allow then to impede efficient entry; and (3) that the mechanism be as simple as possible to administer. Ad Hoc concurs with these objectives, and will discuss, below, how each of the alternative approaches identified by the Commission would meet, or fail to meet, these objectives.

To set the rate ceilings, the Commission suggests using a proxy or surrogate that "does not require use of a cost study" but which "could approximate a rate derived through a detailed cost study." The advantages of this general approach, as identified by the Commission, are that it would (1) simplify the process of setting such rates, (2) reduce the need for carriers to keep, and for the Commission to examine, detailed records, such as are required to support examinations of the carriers' rate bases, and (3) serve as a check on the manipulation of cost data in the exclusive control of incumbent LECs. The

Ad Hoc Committee agrees that a simpler and more objective process is highly desirable. However, the Committee cautions that using a proxy approach does not eliminate the need for detailed and hands-on analysis of the cost methodologies and cost inputs upon which the proxy is based.

In the NPRM, the Commission identifies several possible methods for establishing a rate ceiling by proxy: (1) using some measure of nationally-averaged costs for incumbent LECs; (2) employing a generic cost study, such as those represented by the Benchmark Cost Model submitted by MCI, Sprint, US West, and NYNEX in CC Docket No. 80-286 or the Hatfield Model sponsored by MCI; (3) basing ceilings on existing rates, from incumbent LEC interconnection arrangements with neighboring incumbent LECs, CMRS providers, or CLECs; and (4) deriving unbundled element rates from existing interstate access rates. The Ad Hoc Committee has serious concerns with several of these approaches.

The first approach suggested by the Commission, using a measure of the nationally-averaged costs of incumbent LECs, is particularly troubling. First, although the NPRM does not specify what type of costs are intended, the incumbent LECs are likely to urge the use of embedded costs. There is widespread agreement that the ILECs' embedded costs are not the appropriate economic cost for pricing unbundled elements and interconnection. The Commission has also acknowledged that the use of embedded costs appears to be strongly disfavored, if not outright banned, by the Act. Second, assuming that some more appropriate cost methodology is intended, there are likely to be

serious problems with the results that would be averaged under this approach. Incumbent LECs could use a wide variety of methodologies, cost factors, and other variables that would make the "average" simply a hodge-podge of unverifiable and inconsistently derived numbers.

This approach clearly violates all of the Commission's stated objectives: it would not be simple (unless the Commission simply looked the other way and accepted inputs without critical examination), it would simply aggregate the cost manipulations of incumbent LECs, as a group, and would, particularly if based on embedded costs, result in rate ceilings at which competitive entry could not be attained.

The second approach discussed is the use of a generic cost study, such as the cost proxy models that have been submitted in the context of various universal service proceedings. The Ad Hoc Committee sees this approach as having considerable promise. More than any of the alternative proxy approaches set forth in the NPRM, this approach has the potential to satisfy the criteria identified by the Commission at paragraph 135. A properly specified proxy model will allow the Commission to set ceiling prices that are economically efficient, objective, and based on non-proprietary inputs. However, it is important that the Commission not assume that using a cost proxy model (or any other proxy approach) can be accomplished without a detailed analysis of the methodology, assumptions, and inputs. In reality, there is considerable up-front work that must be done to produce a cost proxy model that reflects the relevant

costs, and captures them in a reliable and verifiable manner.[45] As clearly evidenced in several contentious state proceedings involving the proposed use of various cost proxy models to determine universal service support, as well as the Commission's own Universal Service docket, the process of working out the details of a cost proxy model involves many of the same steps involved in setting the methodology and reviewing the inputs to an actual cost study.

Recognizing this, there are nonetheless clear advantages to using a cost proxy model. Such models have the potential to an objective, *forward-looking* measure of cost, assuming efficient engineering and design. The use of a generic cost model is clearly suited to satisfying the Commission's objective of removing the data-production and cost allocation biases that come from using cost studies produced under the exclusive control of the incumbent LECs. Once the core methodology is fully developed, such a generic model would help to eliminate a large portion of the idiosyncratic methodologies and LEC-controlled inputs that make reviewing cost studies on a company-by-company basis such an unwieldy proposition. The approach that need to be taken if a generic cost model is to be used it to allow vigorous examination of the inputs at the front end, to ensure that good results (with less subsequent efforts) can be obtained over the long run.

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45 For a detailed discussion of the desirable attributes of a cost proxy model, see Chapter 2 of The Cost of Universal Service: A Critical Assessment of the Benchmark Cost Model, Susan M. Baldwin and Lee L. Selwyn, Economics and Technology, Inc., April, 1996, submitted as an Appendix to the Comments of the National Cable Television Association in CC Docket 96-45

The third method discussed in the NPRM is to use rates in existing interconnection and unbundling arrangements, such as those between incumbent LECs and neighboring incumbents, with CMRS providers, and with CLECs. The Ad Hoc Committee agrees with the Commission's analysis of the disadvantages with this approach: that such prices are not, in all probability, cost-based, that the arrangements are between parties with unequal bargaining power, and that the services covered by these may not match what competitive entrants need to purchase. Certainly, when two neighboring incumbents (each a monopolist in its respective market) set interconnection rates, there is no serious pressure to arrive at economically efficient rates. Just as clearly, the rates that have been "negotiated" to date by CLECs have been agreed to under circumstances of vastly unequal bargaining power and frequently with the assumption that the rates were temporary or transitional in nature, pending the development of cost (TSLRIC)-based rates. Each of the problems identified by the Commission is serious in nature and is a sufficient and independently compelling ground for the Commission to reject this approach.

The final approach considered in the NPRM is to use existing elements of interstate access charges as the basis for establishing the ceiling price of certain unbundled network elements. The first disadvantage of this approach is that it is limited to a subset of the interconnection and unbundled network elements that need to be priced. Setting rates for other elements that could not be derived from access rates would involve developing and using a separate approach.

Beyond this consideration, there are other reasons why this approach should not be employed. As the Commission itself recognizes, these rates do not reflect forward-looking, incremental costs, but rather the ILECs' embedded costs, as adjusted over the past several years under price cap regulation. The Commission appears to implicitly recognize that these rates would tend to violate the principle that rate ceilings for unbundled elements and interconnection should not exceed the level at which competitors could attain economically sustainable entry. Yet the Commission proposes that, perhaps, these rates would be an acceptable starting point if a means could be devised to push them downward, over time, towards economic costs. The advantage of simplicity in using access charge-based rates is clearly outweighed by the inappropriateness of the rates themselves as a benchmark for pricing unbundled elements and interconnection. The Ad Hoc Committee is, further, not persuaded that adopting an uneconomic approach as an "interim" solution[46] is in the best interests of competition.

M. The FCC must reject ILECs' attempts to recover embedded costs

The Commission seeks comment in paragraph 144 of the Notice on the relevance of embedded costs to the determination of cost-based rates under § 252(d)(1) of the 1996 Act. Embedded (i.e., historical or ARMIS costs) include previously-acquired (and perhaps economically and/or technologically obsolete)

46 As with other established methods that favor the incumbent LEC over competitors, there is a strong incentive for the interim method to be prolonged and adopted as a semi-permanent solution.

plant and equipment, and thus should not serve as the basis for determining the pricing level for unbundled network elements in the future. Embedded costs for capital-intensive services such as the unbundled local loop reflect past inefficiencies, including overbuilt plant, and may also reflect management decisions that were motivated by competitive strategies for which neither ratepayers or prospective competitors should bear responsibility. Second, because historical or ARMIS costs are the ILECs' reported costs, reliance upon them would not create any incentive for ILECs to maximize their network and operational efficiencies. The FCC could greatly simplify this proceeding by flatly rejecting incumbents' efforts to retain vestiges of embedded costs in the pricing of interconnection. Incumbent LECs have absolutely no entitlement to the difference between the forward-looking TSLRIC and the historical costs associated with the construction and maintenance of the public switched telephone network.[47]

In response to one of the FCC's questions in paragraph 144 of the NPRM, only a very small portion of the difference between the sum of the TSLRIC and the embedded costs can be attributed to universal service support flows. Consistent with the Act, Ad Hoc fully supports the contribution by all telecommunications providers to the achievement of universal service goals. Ad Hoc, however, is greatly disturbed by incumbents' attempt to shield their entire

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47 For a more detailed discussion of this issue, see Stranded Investment and the New Regulatory Bargain, Time Warner Communications Inc. Telecommunications Policy White Paper; California PUC R.95-01-020/I.95-01-021, Universal Service Proceeding, Rebuttal Testimony of Lee L. Selwyn, April 24, 1996, at 12-17.

historical revenue stream in the name of universal service. Universal service support should be limited to well-defined, specific purposes, and thus only to the following: income-targeted support, high-cost support, and TRS support.

Ad Hoc concurs with the FCC's tentative conclusion that use of the efficient component pricing rule ("ECPR") or equivalent methodologies to set prices for interconnection and unbundled network elements would be inconsistent with the § 252(d)(1) requirement for cost-based prices.[48] The ECPR, which sanctions the ill-conceived idea that the incumbent carrier should be "made whole" for the loss of contribution that is associated with the loss of a customer, provides a weak excuse for ILECs to engage in anticompetitive pricing. The ECPR has no resemblance to an economically efficient, cost-based approach to setting prices for interconnection and network unbundling. Simply because a customer migrates from an incumbent to another supplier does not in anyway justify the overpricing of those noncompetitive rate elements that a new entrant requires in order to compete with the incumbent carrier.

N. Rate structure decisions are premature

Ad Hoc believes that the major rate structure questions can not be addressed fully until the Commission resolves the questions posed earlier in the NPRM regarding the appropriate approach to, and level of, unbundling. Ad Hoc urges the Commission not to rush into a final decision on rate structure issues before adequate information on the network elements to be priced and the actual

48 NPRM at ¶ 148.

cost characteristics of these elements are known. It is appropriate, however, for the Commission to begin to adopt principles to be used in a later determination of rate structure, and the underlying principle should be that the recovery of costs should generally reflect the manner in which those costs are incurred.

IV. AVAILABILITY OF INTERCONNECTION FEATURES AND FUNCTIONS

Nothing in the Act prohibits carriers from offering interconnection and unbundled network elements to users, IXCs, ESPs, system integrators, and other "third parties." The Commission should therefore broaden access to interconnection services and unbundled network elements to include these entities. The Notice in para. 114 asks whether the Commission should exercise its authority under § 201 of the Communications Act to require third party access to unbundled Advanced Intelligent Network ("AIN") elements, to the extent that § 251 does not impose such a requirement on the ILECs. The Commission should use the same authority not only to broaden access to AIN elements but to broaden access to *all* interconnection services and unbundled network elements.

The ILECs' attempts to impose artificial distinctions between the services obtained by CLECs in the form of unbundled network elements and those obtained by users, IXCs, system integrators, and enhanced service providers ("ESPs") in the form of Part 69 access and local exchange services are doomed to failure. Artificial price distinctions among identical products are not sustainable over time. If interconnection with unbundled network elements and Part 69 access services look and feel and sound like the same product,